FLAG FINANCIAL CORP
Form 10-Q
May 15, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2001

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from _____ to ______

Commission file number 0-24532

FLAG FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Georgia	58-2094179
(State of incorporation)	(I.R.S. Employer Identification No.)
P.O. Box 3007 LaGrange, Georgia	30241
(Address of principal executive offices)	(Zip Code)

(706) 845-5000

(Telephone Number)

Indicate by check mark whether the registrant has (1) filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES XX NO

Common stock, par value $1 per share: 7,978,001 shares
Outstanding as of May 10, 2001

FLAG FINANCIAL CORPORATION AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
FLAG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	MARCH 31 2001	DECEMBER 31, 2000
ASSETS	(UNAUDITED)	
Cash and due from banks	$ 6,085,653	$ 19,143,110
Federal funds sold	12,974,000	2,730,000
Total cash and cash equivalents	19,059,653	21,873,110
Interest-bearing deposits	917,416	3,451,440

Investment securities available-for-sale	96,627,474	100,721,942
Other investments	5,949,259	5,360,609
Mortgage loans held for sale	6,524,003	4,120,659
Loans, net	387,029,170	384,661,335
Premises and equipment, net	14,481,948	14,933,761
Other assets	23,427,850	23,914,244
Total assets	$554,016,773	$ 559,037,100
LIABILITIES		
Non interest-bearing deposits	$ 46,966,353	$ 55,110,513
Interest-bearing deposits	409,749,881	406,326,454
Federal funds purchased and repurchase agreements	1,199,606	661,482
Other borrowings	-	1,500,000
Advances from Federal Home Loan Bank	30,810,774	31,973,304
Other liabilities	8,468,168	7,966,736
Total liabilities	497,194,782	503,538,489
STOCKHOLDERS' EQUITY		
Preferred stock (10,000,000 shares authorized, none issued and outstanding)	-	-
Common stock ($1 par value, 20,000,000 shares authorized 8,277,995 and 8,275,405 shares issued in 2001 and 2000, respectively	8,277,995	8,275,405
Additional paid-in capital	11,354,511	11,348,106
Retained earnings	37,859,392	37,068,696
Accumulated other comprehensive income (loss)	1,203,610	(265,517)
Less: Treasury stock at cost; 299,994 shares in 2001 and 152,744 shares in 2000	(1,873,517)	(928,079)
Total stockholders' equity	56,821,991	55,498,611
Total liabilities and stockholders' equity	$554,016,773	$ 559,037,100

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENTS OF OPERATIONS

	THREE MONTHS ENDED MARCH 31,	
	2001	2000
	(UNAUDITED)	
INTEREST INCOME		

Interest and fees on loans	$ 9,963,107	$10,320,866
Interest on securities	1,730,191	1,445,283
Interest on federal funds sold and interest-bearing deposits	161,133	112,522
Total interest income	11,854,431	11,878,671
INTEREST EXPENSE		
Interest on deposits	4,960,322	4,668,100
Interest on borrowings	493,727	527,923
Total interest expense	5,454,049	5,196,023
Net interest income before provision for loan losses	6,400,382	6,682,648
PROVISION FOR LOAN LOSSES	252,000	593,070
Net interest income after provision for loan losses	6,148,382	6,089,578
OTHER INCOME		
Fees and service charges	1,189,334	1,280,249
Gain (loss) on sale of available for sale securities	-	41,997
Gain on sale of loans	273,149	194,813
Other income	370,252	400,468
Total other income	1,832,735	1,917,527
OTHER EXPENSES		
Salaries and employee benefits	3,476,410	3,809,917
Occupancy	944,982	1,075,903
Other operating	1,807,711	2,297,295
Total other expenses	6,229,103	7,183,115
Earnings before provision for income taxes	1,752,014	823,990
Provision for income taxes	482,638	147,584
Net earnings	$ 1,269,376	676,406
Basic earnings per share	$ 0.16	$ 0.08
Diluted earnings per share	$ 0.16	$ 0.08

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	THREE MONTHS ENDED MARCH 31, 2001	2000
	(UNAUDITED)	
Net earnings	$ 1,269,376	676,406

Other comprehensive income, net of tax:		
Unrealized gains (losses) on investment securities available-for-sale:		
Unrealized gains (losses) arising during the period, net of tax of $824,433 and $310,855 respectively	1,345,127	(507,184)
Less: Reclassification adjustment for gains included in net earnings, net of tax of 15,959		26,038
Unrealized gain on cash flow hedges, net of tax of $76,000 .	124,000	
Other comprehensive income (loss)	1,469,127	(533,222)
Comprehensive income.	$ 2,738,503	143,184

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CASH FLOWS

	THREE MONTHS EN MARCH 31,	
	2001	2
	(UNAUDITED)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings.	$ 1,269,376	67
Adjustment to reconcile net earnings to net cash provided by operating activities:		
Depreciation, amortization and accretion.	683,927	78
Provision for loan losses	252,000	59
(Gain) loss on sale of investment securities available for sale .	-	(4
Gain on sales of loans.	(273,149)	(19
Loss (gain)on sale of other real estate	7,955	(
Change in:		
Mortgage loans held for sale	(2,130,195)	(9
Other.	(196,689)	(1,42
Net cash (used in) provided by operating activities . . .	(386,775)	28
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net change in interest-bearing deposits	2,534,024	70
Proceeds from sales and maturities of investment securities available-for-sale	6,297,494	2,49
Proceeds from maturities of investment securities held-to-maturity. . .	-	13
Purchases of other investments.	(588,650)	
Net change in loans	(2,619,835)	(4,14
Proceeds from sale of other real estate	306,604	11
Proceeds from sale of premises and equipment.	112,438	2
Purchases of premises and equipment	(162,099)	(33
Purchases of cash surrender value life insurance.	(46,397)	(4

Net cash provided by (used in) investing activities	5,833,579	(1,07
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net change in deposits	(4,720,733)	(5,36
Change in federal funds purchased	538,124	(2,51
Change in other borrowed funds	(1,500,000)	1,50
Proceeds from FHLB advances	-	5,50
Payments of FHLB advances	(1,162,530)	(8,06
Purchase of treasury stock	(945,437)	(35
Proceeds from exercise of stock options	8,995	
Cash dividends paid	(478,680)	(49
Net cash used in financing activities	(8,260,261)	(9,77
Net change in cash and cash equivalents	(2,813,457)	(10,56
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	21,873,110	27,08
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$19,059,653	16,51

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying consolidated financial statements have not been audited. The results of operations are not necessarily indicative of the results of operations for the full year or any other interim periods.

The accounting principles followed by FLAG Financial Corporation ("FLAG") and its bank subsidiary and the methods of applying these principles conform with generally accepted accounting principles and with general practices within the banking industry. Certain principles, which significantly affect the determination of financial position, results of operations, and cash flows are summarized below and in FLAG's annual report on Form 10-K for the year ended December 31, 2000.

Note 1. Basis of Presentation

The consolidated financial statements include the accounts of FLAG and its wholly owned subsidiary, FLAG Bank (Vienna, Georgia). All significant inter-company accounts and transactions have been eliminated in consolidation.

The consolidated financial information furnished herein represents all adjustments that are, in the opinion of management, necessary to present a fair statement of the results of operations, and financial position for the periods covered herein and are normal and recurring in nature. For further information, refer to the consolidated financial statements and footnotes included in FLAG's annual report on Form 10-K for the year ended December 31, 2000.

Note 2. Earnings Per Share

Net earnings per common share are based on the weighted average number of common shares outstanding during each period. The calculation of basic and diluted earnings per share is as follows:

	THREE MONTHS ENDED MARCH 31,	
	2001	2000
Basic earnings per share:		
Net earnings.	$1,269,376	676,406
Weighted average common shares Outstanding	8,031,583	8,239,888
Basic earnings per share	$ 0.16	0.08
Diluted earnings per share:		
Net earnings.	$1,269,376	676,406
Effect of dilutive securities - stock options.	21,749	25,931
Diluted earnings per share	$ 0.16	0.08

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ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FINANCIAL CONDITION

OVERVIEW

Total assets were $554.0 million at March 31, 2001, a decrease of $5.0 million or .9 percent from December 31, 2000. This decrease in total assets was primarily due to decreases in investment securities available-for-sale as a result of maturities and calls during the quarter ended March 31, 2001.

ASSETS AND FUNDING

At March 31, 2001 earning assets totaled $510.0 million, an increase of $9.0 million from December 31, 2000. Loans comprised 76 percent of earning assets and investment securities were 20 percent of earning assets at March 31, 2001.

At March 31, 2001, interest-bearing deposits increased $3.4 million compared to December 31, 2000. Non-interest bearing deposits decreased $8.1 million in the first three months of 2001 and totaled $47.0 million at March 31, 2001. The decrease in non-interest bearing deposits for the first three months of 2001 was mainly attributed to a seasonal reduction of approximately $5 million in one commercial demand deposit account. Federal Home Loan Bank advances decreased $1.2 million in the first three months of 2001 and totaled $30.8 million at March 31, 2001. At March 31, 2001 deposits represented 93 percent of FLAG's interest-bearing liabilities and Federal Home Loan Bank advances represented 7 percent.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used by operating activities totaled $400 thousand for the three months ended March 31, 2001. Net cash provided by investing activities totaling $5.8 million consisted largely of $6.3 million in proceeds from sales and maturities of investment securities available-for-sale and a net decrease in interest-bearing deposits of $2.5 million partially offset by a $2.6 million increase in loans outstanding. Net cash used in financing activities consisted largely of a $4.7 million decrease in deposits, a $1.5 million decrease in other borrowings and a $1.2 million in Federal Home Loan Bank advances.

Total stockholders' equity at March 31, 2001, was 10.26 percent of total assets compared to 9.93 percent at December 31, 2000. The increase is attributed to a $1.3 million decrease in net earnings since December 31, 2000, less dividends paid to stockholders.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS
Three months ended March 31, 2001 and 2000

OVERVIEW
Net earnings for the three months ended March 31, 2001 increased $593,000 or 88 percent compared to the first three months of 2000. Net earnings per common share increased 100 percent for the first three months of 2001 and are $0.16 compared to $0.08 in the first three months of 2000. Net interest income decreased 4 percent for the three months ended March 31, 2001 over the same period of 2000 to $6.4 million. Non-interest income decreased 4 percent for the first three months of 2001 compared to the same period of 2000 and non-interest expense decreased 13 percent for the first three months of 2001 compared to 2000.

NET INTEREST INCOME
Net interest income for the three months ended March 31, 2001 decreased $282,000 compared to the first three months of 2000. This decrease resulted from a $24,000 or .20 percent decrease in interest income coupled with a $258,000 or 5 percent increase in interest expense.

NON-INTEREST INCOME AND EXPENSE
Non-interest income for the three months ended March 31, 2001 decreased $85,000 or 4 percent compared to the first three months of 2000. This increase was due largely to a decrease of $91,000 in fees and service charges, partially offset by an increase of $78,000 in gain on sale of loans.

Other operating income decreased $30,000 or 8 percent for the quarter ended March 31, 2001 compared to the same period in 2000. This decrease was due in large part to decreased mortgage servicing fees for the first three months of 2001 compared to 2000.

Non-interest expense decreased $954,000 or 13 percent for the quarter ended March 31, 2001 compared to the same period of 2000. Salaries and employee benefits decreased $333,000 or 9 percent during the first three months of 2001 compared to 2000. The decrease in non-interest expense was primarily attributed to reduced expenses as a result of the sale of branches during the third quarter of 2000.

INCOME TAXES
Income tax expense for the first quarter of 2001 was $483,000 compared to $148,000 for the same period in 2000. The effective tax rate for the quarter ended March 31, 2001 was 28 percent and for the quarter ended March 31, 2000 was 18 percent.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

PROVISION AND ALLOWANCE FOR POSSIBLE LOAN AND LEASE LOSSES

The adequacy of the allowance for loan and lease losses is determined through management's informed judgment concerning the amount of risk inherent in FLAG's loan and lease portfolios. This judgment is based on such factors as the change in levels of non-performing and past due loans and leases, historical loan loss experience, borrowers' financial condition, concentration of loans to specific borrowers and industries, estimated values of underlying collateral, and current and prospective economic conditions. The allowance for loan and lease losses at March 31, 2001 was $6.9 million compared to $6.6 million at December 31, 2000. The ratio of the allowance for loan losses to net outstanding loans at March 31, 2001 and December 31, 2000 was 1.76 percent and 1.68 percent, respectively.

Management believes that the allowance for loan losses is both adequate and appropriate. However, the future level of the allowance for loan losses is highly dependent upon loan growth, loan loss experience, and other factors, which cannot be anticipated with a high degree of certainty.

NON-PERFORMING ASSETS AND PAST DUE LOANS

Non-performing assets, comprised of real estate owned, non-accrual loans and loans for which payments are more than 90 days past due, totaled $8.9 million at March 31, 2001 compared to $12.8 million at December 31, 2000. Non-performing assets as a percentage of net loans and other real estate owned at March 31, 2001 and December 31, 2000 were 2.31 percent and 3.28 percent, respectively.

FLAG has a loan review function that continually monitors selected accruing loans for which general economic conditions or changes within a particular industry could cause the borrowers financial difficulties. The loan review function also identifies loans with high degrees of credit or other risks. The focus of loan review as well as FLAG management is to maintain a low level of non-performing assets and return current non-performing assets to earning status.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

At March 31, 2001, FLAG and its bank were in compliance with various regulatory capital requirements administered by Federal and State banking agencies. The following is a table representing FLAG's consolidated Tier-1 Capital, Tangible Capital, and Risk-Based Capital:

MARCH 31, 2001

	ACTUAL AMOUNT	%	REQUIRED AMOUNT	%	EXCESS AMOUNT	%
Tier 1 Capital	$47,312	8.59%	$22,041	4.00%	$25,271	4.59%
Tangible Capital	$47,312	8.59%	$ 8,265	1.50%	$39,047	7.09%
Risk-Based Capital	$52,718	12.23%	$34,492	8.00%	$18,226	4.23%

PART 2. OTHER INFORMATION
FLAG FINANCIAL CORPORATION AND SUBSIDIARIES

PART II. Other Information

Item 1. Legal Proceedings

FLAG and the Bank are periodically involved as plaintiff or defendant in various legal actions in the ordinary course of its business.

As previously reported, FLAG Bank purchased certain warehouse loans of Gulf Properties Financial Services, Inc., a residential mortgage broker. The loans that Gulf Properties sold to FLAG Bank were fraudulent. Gulf Properties filed Chapter 11 bankruptcy on December 30, 1998. FLAG Bank is serving on the creditors' committee and is assisting in the liquidation of assets, which will be distributed on a pro rata basis among the creditors. As of December 31, 2000, FLAG Bank has collected approximately $950,000 as part of the bankruptcy proceedings. Additionally, FLAG Bank has received $1.6 million from a claim under its fidelity bond regarding this matter. The perpetrators of the fraud have pled guilty to criminal charges and have been sentenced to prison. FLAG Bank obtained a restitution order as part of the criminal sentence. FLAG Bank's exposure as a result of the fraud was approximately $3 million. Several other banks also purchased fraudulent loans from Gulf Properties and the total amount of exposure of all banks is approximately $32 million.

As previously reported, Tad Moore Golf, Inc. is a borrower of FLAG Bank. An investor in Tad Moore Golf, Inc., who is also a lender to Tad Moore Golf, Inc., sued FLAG Bank in Southern District Court in New York alleging that FLAG Bank fraudulently induced the investor into allegedly subordinating his loan to the loan of FLAG Bank. The investor was also a borrower of FLAG Bank. The plaintiff is claming $1.6 million in consequential damages and $10 million in punitive damages. FLAG Bank has succeeded in having the venue of this matter transferred from New York to United States District Court in Newnan, Georgia. FLAG Bank settled the matter in its favor in March of this year.

On June 28, 2000, David and Trenne Baker filed a suit against America's Homeplace, Southern Homestead Mortgage and FLAG Bank in Superior Court of Bartow County, Georgia. The Complaint alleges that the defendants are liable to the plaintiffs for unspecified damages for fraud, suppression and concealment, breach of contract, intentional infliction of emotional distress, negligent infliction of emotional distress, conspiracy and violations of Georgia RICO arising out of the construction and purchase of a house from a co-defendant by the plaintiff. FLAG Bank provided the construction financing on the home. Co-defendant America's Homeplace has filed a motion to compel arbitration in accordance with the plaintiff's contract. The motion was granted and the plaintiffs are now pursuing their claim against AHP only in an arbitration proceeding. FLAG Bank intends to vigorously defend the claims.

In September 2000, Bank of Milan filed suit against one of its Borrowers, Walter T. Branyan, to collect upon an outstanding loan in the amount of $1,349,066.66. The Bank of Milan also filed suit against the borrower's father, Walter C. Branyan, and a business associate, R. Tommy Gilder as Guarantors of the obligation. Walter C. Branyan has settled his obligation with the Bank of Milan and the court has entered a default judgment against Walter T. Branyan. R. Tommy Gilder is defending the suit and has counterclaimed against the Bank for breach of fiduciary duty based upon an alleged confidential relationship with the Bank of Milan. Gilder's defenses and counterclaims are without merit and the Bank of Milan intends to pursue and defend this matter vigorously.

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OTHER INFORMATION

Item 2. Changes in Securities - None

Item 3. Defaults upon Senior Securities - None

Item 4. Submission of Matters to a Vote of Security Holders

(a) The 2001 Annual Meeting of Shareholders was held on April 18, 2001.

(b) Election of Directors

The following are the results of the votes cast by shareholders present at the 2001 Annual Meeting of Shareholders, by proxy or in person, for the proposal to elect the following directors to serve until the 2004 Annual Meeting of Shareholders:

	For	Withhold
Dr. A. Glenn Bailey	6,235,928	209,935
James A. Brett	6,234,928	210,935
David B. Dunaway	6,235,928	209,935
John R. Hines, Jr.	6,231,700	214,163
Kelly R. Linch	6,235,928	209,935
J. Daniel Speight, Jr.	6,227,600	218,263

Additionally, the shareholders voted 6,235,928 in the affirmative and 209,935 were withheld for the election of Charles O. Hinely to serve a term of one year until the 2002 Annual Meeting of Shareholders.

(c) Ratifying the appointment of Porter Keadle Moore LLP, as independent accountants of the Company for the fiscal year ending December 31, 2001.

The shareholders voted 6,430,677 shares in the affirmative, 3,709 shares in the negative, with 11,477 shares abstaining for the ratification and appointment of Porter Keadle Moore LLP as independent accountants for the Company for the fiscal year ending December 31, 2001.

(d) Amending the Company's 1994 Employees Stock Incentive Plan

The shareholders voted 3,985,524 in the affirmative and 623,409 shares in the negative, with 49,112 shares abstaining for the amendment of the 1994 Employees Stock Incentive Plan.

(e) Amending the Company's 1994 Directors Stock Incentive Plan

The shareholders voted 3,874,216 in the affirmative and 663,788 shares in the negative, with 120,041 shares abstaining for the amendment of the 1994 Directors Stock Incentive Plan.

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OTHER INFORMATION

Item 5. Other Information

Pursuant to Rule 14a-14(c)(1) promulgated under the Securities Exchange Act of 1934, as amended, shareholders desiring to present a proposal for consideration at the Company's 2002 Annual Meeting of Shareholders must notify the Company in writing to the Secretary of the Company, at Eagle's Landing, 235 Corporate Center Drive, Stockbridge, Georgia 30281 of the contents of such proposal no later than November 12, 2001 to be included in the 2002 Proxy Materials. A shareholder must notify the Company before January 26, 2002 of a proposal for the 2002 Annual Meeting that the shareholder intends to present other than by inclusion in the Company's proxy material. If the Company does not receive such notice prior to January 26, 2002, proxies solicited by the management of the Company will confer discretionary authority upon the management of the Company to vote upon any such matter.

Item 6. Exhibits and Report on Form 8-K

Reports on Form 8-K filed during the First Quarter of 2001:

None.

Reports on Form 8-K filed from Quarter End 2001 to Present:

None.

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FLAG FINANCIAL CORPORATION AND SUBSIDIARIES

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

FLAG Financial Corporation

By: /s/ Thomas L. Redding

Thomas L. Redding
(Chief Financial Officer)

Date: May 15, 2001

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